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Spotlight on AML: the EU's prevention plans and what it can learn from the US

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Chris Warren-Smith at Morgan Lewis in London and former US federal prosecutor David I Miller at Morgan Lewis in New York consider how the EU's new anti-money laundering proposals may help drive much-needed change, and assess the more mature AML regime in the US and what could be learned from its experience as the EU framework is developed.

Money laundering is a significant global concern and not just an issue for the EU. While certain countries have been leading the way against people and organisations engaged in money laundering (and terrorist financing), it is fair to say that the EU has been, at best, in the middle of the pack.

The EU has acknowledged publicly that anti-money laundering (AML) supervision has failed too often across the EU and that it is only as strong as its weakest link.

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Ever-changing and advanced techniques are used to launder money and finance terrorism. Virtual currencies are bringing new opportunities to criminals. There is a clear recognition of the need for European institutions to tackle this issue head on.

Against this backdrop, on 12 September 2018, the European Commission unveiled new proposals to strengthen the powers of EU institutions to tackle this serious crime that can undermine the integrity of financial services. The announcement acknowledged that money laundering remains an issue to be addressed, notwithstanding the steps already taken at both EU and national level to date, saying: *"Despite...strengthened legislative framework, several recent cases of money laundering in European banks have given rise to concerns that gaps remain in the Union's supervisory framework."*

Although action at an EU level will not bring an end to money laundering, there is hope that the powers suggested in the latest proposals will significantly improve the situation both at an EU level and outside the EU.

The European Commission's Proposals

Central to the EC's proposals is providing the European Banking Authority (EBA) with the power to ensure *"effective cooperation and convergence of supervisory standards."* Having seen the existing system – in which responsibility for supervision and enforcement is at member state level – fail to be effective, an important step is suggesting that the EBA is *"entrusted specifically"* with necessary functions.

The proposals are broadly aimed at providing the EBA with the tools to take on a co-ordinating role in the EU's supervision around money laundering and ensuring that breaches of AML laws are consistently investigated at a national level.

It is envisaged that the EBA would become the "data-hub": collecting information on AML supervision throughout the EU, developing common standards, monitoring market developments and coordinating communications.

The proposals, if implemented would allow the EBA to request that national authorities investigate potential material breaches and consider appropriate sanctions.

Some have suggested that the centralised powers contained in these proposals are long overdue. Certainly, recent examples of failures across the EU have shown that to tackle AML issues effectively and efficiently, a consistent approach

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is needed at the EU level, rather than relying on action at a national level. There is a clear need for a single authority to take the lead in ensuring co-ordination between member states, which the proposals seek to address.

Under the proposals, member states suspected to have taken a more lenient approach to AML (and have national laws, or enforcement authorities, which are not effective in tackling AML issues) will need to answer to the EBA. If properly implemented, this step should operate as a fundamental deterrent to those targeting criminal activities through particular member states.

Data collection and analysis will be key. The EBA's function of collating experience, techniques, and information from national authorities and, in effect, sharing these throughout the EU, will be a powerful tool. A similar approach to information sharing has already benefited areas such as security intelligence.

Key Challenges Facing the EU

The European Commission's proposals are to be commended and supported. However, experience suggests that simply providing the EBA with powers that should help with this fight are unlikely to be sufficient.

The EBA, which currently has (the equivalent of) 1.8 full-time staff members working on AML issues, will have to ensure that it has a workforce large enough (and capable enough) to use the proposed powers effectively. There is a stated intention to increase this resource, which is an important step. Having powers in place to tackle criminals engaged in money laundering is one thing; being able to utilise those powers effectively is quite another.

Further, and importantly, although the EBA will have a significant role to play, much will still depend on the willingness, and ability, of member states to enforce AML laws.

The US regime

It is instructive to consider the more developed US regime and how its experience might be used to bolster the EU proposal.

The US has multiple laws designed to combat AML and terrorism financing. US enforcement authorities have been diligently enforcing these laws, especially since the 11 September 2001 attacks.

There is no one repository for US AML laws. Rather they are contained within several statutes and regulations, including: the Bank Secrecy Act (BSA); anti-

money laundering statutes, such as the Money Laundering Control Act; anti-money laundering reporting requirements (as required by the BSA and the Department of Treasury's Financial Crimes Enforcement Network (FinCEN) regulations); federal criminal statutes precluding material assistance to terrorism, including terrorist financing; and the policies and procedures enforced by FinCEN.

These overlapping and complementary rules are enforced by several United States authorities, including the Department of Justice (DOJ), FinCEN, Securities and Exchange Commission (SEC), Office of the Comptroller of Currency (OCC), Board of Governors of the Federal Reserve System (FRB), District Attorney's Offices, State Attorneys General Offices, and the Financial Industry Regulatory Authority (Finra).

The BSA contains key AML provisions to which a broad array of institutions – including foreign institutions with some US nexus – must adhere. For example, the BSA imposes requirements on "financial institutions" (a term of art that is broadly defined) to keep records of cash purchases of negotiable instruments, file reports of large cash transactions, and identify and report suspicious activities that might signify money laundering, tax evasion, or other criminal activities.

Financial institutions can be held liable for failing to enact and maintain sufficient monitoring and reporting systems to comply with these requirements and can be held strictly liable for failing to submit required reports.

Following the 11 September attacks, the BSA was amended by the USA Patriot Act, requiring, among other things, all banks to adopt a customer identification programme. That programme must, at a minimum, include: the development of internal policies, procedures, and controls; the designation of a compliance officer; an ongoing employee training programme; and an independent audit function to test the programme's functions.

Financial institutions are required to conduct due diligence on correspondent accounts for foreign financial institutions and private bank accounts, with special scrutiny given to senior foreign political figures, their family members, and associates. Customer due diligence programmes must have written policies and procedures specifically designed to verify and identify the source of client funds through a documented verification process. Financial institutions must include in their programme a process for identifying "structured" transactions that were deliberately designed to evade the BSA's reporting requirements (this may include, for example, dividing an otherwise large financial transaction into a series of smaller transactions such that each is just below the statutory reporting limit of $10,000, to avoid scrutiny).

Pursuant to the BSA and FinCEN regulations, financial institutions are required to file reports including: Suspicious Activity Reports (SARs); Currency Transaction Reports (CTRs); Foreign Bank and Financial Account Reports (FBARs); and reports of international transportation of currency or monetary instruments (CMIRs). These reporting requirements are outlined by statute and regulation and require financial institutions to make reports in certain instances, including transactions over certain thresholds, activity that may suggest or may implicate insider abuse, foreign financial interests, and transactions that transfer funds in or out of the United States.

Crucially, the US government has instituted a number of large-scale enforcement actions in the BSA/AML arena in recent years. For example, in March 2015, Commerzbank admitted to violations of the BSA and other related rules, paying over $1.45 billion in penalties to settle actions with DOJ, the New York County District Attorney's Office, FRB, the New York State Department of Financial Services, and the Office of Foreign Asset Control. In 2017, Citigroup subsidiary Banamex USA paid approximately $247.44 million in penalties and entered into settlements with DOJ, the Federal Deposit Insurance Corporation, and the California Department of Business Oversight for BSA violations. And in the last year alone, DOJ brought two significant actions related to alleged AML programme deficiencies: US Bancorp settled actions with DOJ, FinCEN, OCC, and FRB, paying over $600 million in penalties as part of a deferred prosecution agreement; and Netherlands-based Rabobank agreed to forfeit nearly $369 million in a plea agreement with DOJ.

Authorities may hold individuals liable for failures in this space as well. For example, earlier this year, the SEC brought actions against the CEO and two former AML compliance officers of Aegis Capital Corporation for aiding and abetting or causing the company to fail to file SARs. The SEC alleged that the individuals failed to file SARs, or take the necessary steps to ensure SARs were filed, despite being aware of red flags and suspicious transactions.

The US anti-terrorism criminal statutes target activities that knowingly provide something of value to persons and groups engaged in terrorist activity. Importantly, these statutes focus on the application of the improper funds – rather than the source of the funds (as US AML laws do) – as terrorist funds may come from a wide variety of seemingly legitimate sources. For example, under these anti-terrorism statutes, financial institutions are required to seize and report any funds in their possession in which a terrorist organisation or its agent has an "interest," and institutions must continuously monitor transactions for potential connections to terrorist organisations. Individuals are also prohibited from engaging in financial transactions with a country that supports international

terrorism (held only to a standard requiring that the person had a “reasonable cause to know” that the country supports terrorism). This statutory scheme also provides a private right of action for victims of terrorism to sue terrorism financiers, including banks.

FinCEN regulations further add to the AML oversight scheme by requiring banks to have policies, procedures, and processes to reasonably assess potential risks associated with, among other things, foreign correspondent accounts. Banks must consider risk factors including: the nature of a foreign financial institution’s business and the markets it serves; the type, purpose, and anticipated activity of each correspondent account; the nature and duration of the relationship with a foreign financial institution; the anti-money laundering and supervisory regime of the jurisdiction of the account; and the foreign institution’s anti-money laundering record. To that end, banks are required to take steps to reasonably ensure that correspondent accounts maintained at foreign branches are not used as shell accounts for foreign banks. These requirements include the implementation of a robust Know Your Customer (KYC) programme to collect and verify basic customer information, as well as information about any potentially suspect beneficial account owners and the source of customer funds (such as high-risk countries, or offshore entities).

As of 11 May 2018, “covered financial institutions” must also comply with FinCEN’s Customer Due Diligence Requirements for Financial Institutions (the CDD Rule). The CDD Rule, “clarifies and strengthens customer due diligence requirements for US banks, mutual funds brokers or dealers in securities, futures commission merchants, and introducing brokers in commodities and adds a new requirement for these covered financial institutions to identify and verify the identity the natural persons (known as beneficial owners) of legal entity customers who own, control, and profit from companies when those companies open accounts.”

These statutes, regulations, and rules are just a few within the web-like but robust US AML enforcement regime. Indeed, there are also essential sanctions and export control laws of which clients doing business in, through, or affecting the US need to be aware. US authorities have been anything but shy in instituting enforcement actions in the AML area seeking large civil and criminal sanctions, including penalties in the hundreds of millions or even billions of dollars. Clients should expect the government’s enforcement focus to continue and seek US counsel accordingly.

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EU proposals compared to the US regime

While there appear to be stark differences between the (proposed) EU and the US AML regimes, there are some similarities.

The laws in place to combat money laundering are contained in various pieces of legislation and there are multiple bodies responsible for enforcing breaches of AML laws and the power and responsibility does not rest with a single body.

It is instructive to see the US regime's requirements generally relate to regular monitoring and reporting, and KYC and customer identification. The EU would do well to consider how a regime that imposed and enforced similar requirements might improve the effectiveness of monitoring and prevention at both member state and institutional levels.

Another interesting possibility is the creation of private rights of action, such as that the US has created for victims of terrorism to sue terrorism financiers, including banks. Although the EU is noticeably reticent to develop private sector rights of litigation – and relies on implementation at member state level – it is an area worthy of consideration.

What, of course, the EU (and its member states) lacks in comparison to the US is a strong record of enforcing AML laws. The US's track record undoubtedly acts as a deterrent to those wishing to engage in this criminal activity. The criminals or terrorists contemplating illegal activities through the US financial system do so with the knowledge that financial institutions themselves are more attuned to the risks and have systems in place to stop AML breaches. A clear target for the EBA must be to develop enforcement across the EU and in member states to foster a similar deterrent effect.

Conclusion

It is apparent that the EU proposals are some distance behind the current regime in the US. This is not unexpected given the EU has operated as a collection of independent member states with respect to AML. It is, only now, looking at enhancing the powers of its institutions in this area centrally.

What is clear is that the EU's proposals are a significant and positive step forward in what will be a long road in the EU's attempt to tackle the issues of AML and terrorist financing. If one thing is to be learned from the US regime, it is that enforcement of the available powers is crucial. Stopping money laundering and terrorist financing will require financial institutions to ensure that they have

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appropriate monitoring systems in place and that concerns are identified, escalated and reported. A culture that fully supports this happening is key.

Further, proper supervision and enforcement will require the buy-in not only of the EBA, but also each member state and their enforcement authorities. Without the commitment from all stakeholders, the proposals are unlikely to have the type of impact we all hope they can achieve.

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